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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 463

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FABLER & CO., INC., *Petitioners,*

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD., *Respondents.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

(Following action taken below after remand by this Court in No. 160, Oct. Term 1952.)

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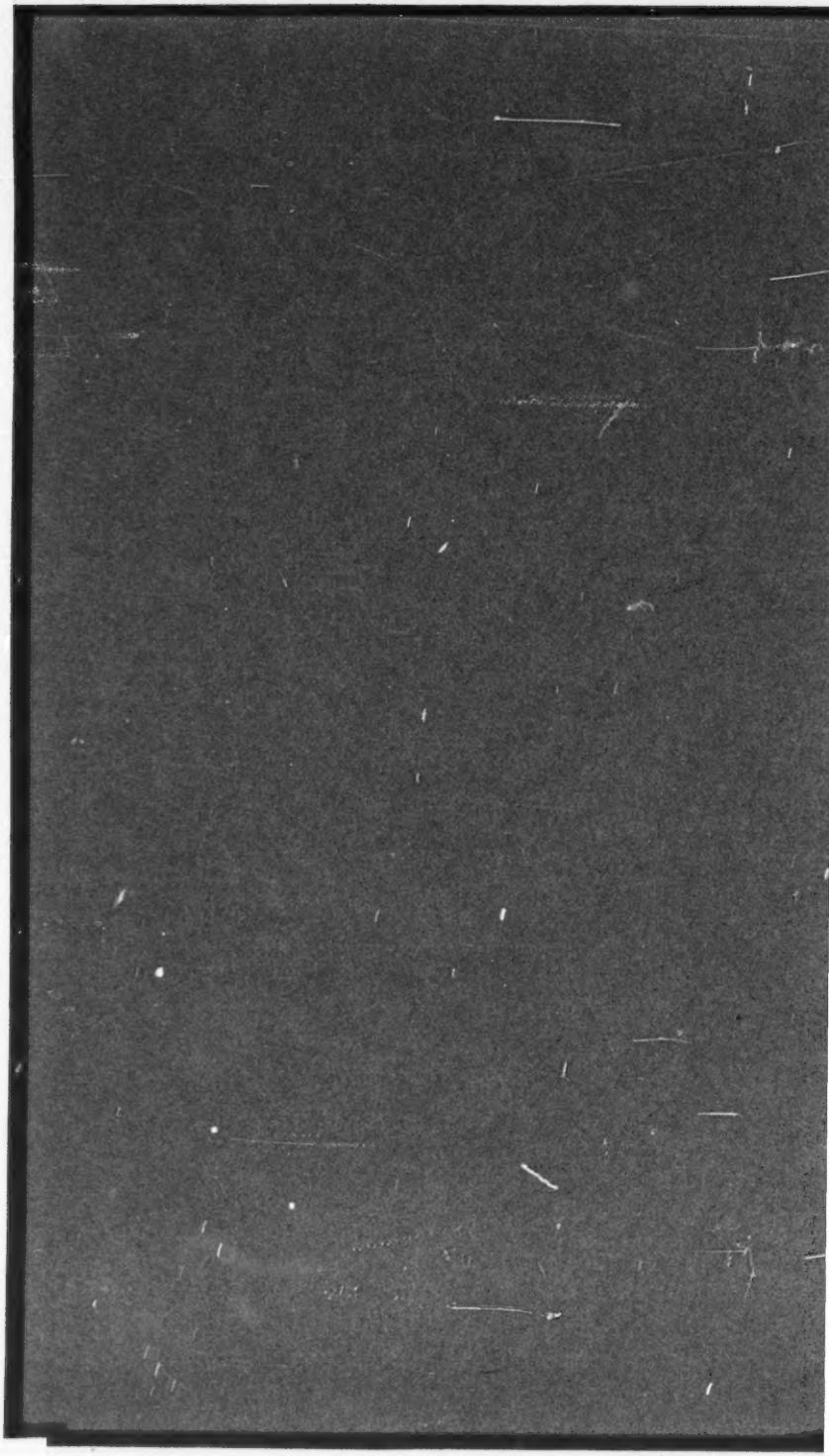

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CHRONOLOGY OF FACTS

Date	
1916	Plaintiff acquires all of the stock of respondent for $75,000,000.
1935	Respondent goes into reorganization.
1940	The District Court approves respondent's reorganization plan.
1943	
Mar. 15	The Supreme Court affirms the approval of respondent's reorganization plan.
June 1	Plaintiff's officers become full-time employees of respondent, paid solely by respondent.
1944	
Apr. 30	Plaintiff transfers its stock in respondent to respondent's reorganization committee.
July 15	Plaintiff files consolidated tax returns for 1943.
Dec. 29	Respondent emerges from reorganization.
1945	
Mar. 9	Plaintiff files the refund claim for 1942 taxes.
June 15	Plaintiff files consolidated tax returns for the first four months of 1944.
1946	
Oct. 10	Plaintiff institutes this action.
1947	
Feb. 11	Polk offers, in plaintiff's name, to settle the tax controversy with the Government.
Apr. 2	Polk notifies plaintiff of this offer.
Aug. 13	The Government accepts the settlement offer.

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OCTOBER TERM, 1953

No. .....

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC.,

Petitioners,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners Metzger, Offerman and Farlee, plaintiffs-intervenors below, pray for a writ of certiorari to review the judgment of the Court of Appeals of October 29, 1951, and its order of August 20, 1953, denying petitioners' application for rehearing and rehearing en banc. Petitioners are preferred stockholders of plaintiff and submit this application simultaneously with plaintiff's own petition.

Previous Opinions Herein

The fourteen judicial opinions heretofore rendered herein—prevailing, concurring and dissenting—are reported:

That of the District Court, at 85 F. Supp. 868 (R. 248);

Those of the Court of Appeals rendered before the remand by this Court, at 197 F. 2d 994 (R. 2214, 2239, 2260, 2261, 2288, 2296, 2313);

Those of this Court, after the grant of certiorari (344 U. S. 809), at 345 U. S. 247; and

Those of the Court of Appeals rendered after the remand, at 205 F. 2d 374 and 206 F. 2d 495 (R. 2354, 2356, 2359, 2363).

Jurisdiction

The judgment of the Court of Appeals was entered October 29, 1951 (R. 2255); its order denying petitioners' applications for rehearing en banc was entered August 20, 1953 (R. 2363).

The District Court had diversity of citizenship jurisdiction (R. 6, 12, 117-8) under 28 U. S. C., § 1332. The Court of Appeals had jurisdiction under 28 U. S. C., § 1291. The jurisdiction of this Court is invoked under 28 U. S. C., § 1254(1).

Statutes Involved

The pertinent portions of §§ 23(g)(4), 122 and 141 of the Internal Revenue Code, of Treas. Reg. 104, §§ 23.12, 23.15 and 23.16, of Rule 52 of the Federal Rules of Civil Procedure, and of § 66 of the (old) Judicial Code, 28 U. S. C. § 125 (old), are set forth in the Appendix hereto.

Statement

1. *Plaintiff's $75,000,000 stock loss.* In 1916, plaintiff, a holding company, acquired for $75,000,000 all the stock of respondent, an operating railroad company (R. 493).*

In 1935, respondent went into reorganization under § 77 of the Bankruptcy Act (R. 494). The reorganization plan, approved by this Court on March 15, 1943, *Eckert* v. *Western Pac. R. Corp.*, 318 U. S. 448, was consummated on December 29, 1944, when the reorganization trustees returned the assets to respondent (R. 499) and respondent assumed the obligations of the trustees (Pl. Ex. 15, R. 1711-3).

The plan provided that plaintiff's stock interest in respondent was without equity and not entitled to share in the assets (R. 259, 495). Plaintiff's $75,000,000 investment was thus wiped out.

2. *Plaintiff's tax credit and its use to save respondent's taxes.* Staggering as plaintiff's loss was, it presented one mitigating feature: The amount of the loss could be used as an income and excess profits tax deduction. I. R. C., § 23(g)(4), enacted in 1942 (56 Stat. 820), provides that losses resulting from the worthlessness of a stock investment in an affiliate are to be treated as operating losses (rather than as capital losses as theretofore).

Plaintiff's loss was so utilized, but plaintiff derived no benefit therefrom. Instead, the entire benefit of plaintiff's tax credit was reaped by respondent. This was accomplished through the mechanics of consolidated tax returns.

Under I. R. C., § 141, consolidated tax returns may be filed for an affiliated group of corporations headed by a common parent and inter-connected by at least 95% stock

* In the record plaintiff is sometimes called the "Corporation", respondent the "Company".

ownership. In such a return, the respective losses and profits of the affiliated corporations are offset against each other and taxes are paid only on the net profit of the group as a whole. Only the parent can file such a consolidated return (Treas. Reg. 104, §§ 23.12, 23.16).

Although this Court's decision of March 15, 1943, had rendered plaintiff's stock interest in respondent worthless, the reorganization was not actually consummated until much later; plaintiff's ownership of respondent's old stock continued therefore until plaintiff surrendered it to respondent's reorganization committee on April 30, 1944 (R. 260). For tax purposes, plaintiff remained respondent's "parent" and had the right to file consolidated returns for the year 1943 and the first four months of 1944 (hereafter referred to as the year 1944).

During this 1943-1944 period, respondent had earned profits from its wartime railroad operations on which it would ordinarily have had to pay more than $17,000,000 in taxes (R. 262). But respondent avoided the payment of this tax by causing plaintiff to file consolidated returns in which plaintiff's stock loss was offset against respondent's profits, relieving respondent from all tax liability. Furthermore, by virtue of the "carry back" provision of I. R. C., § 122(b), plaintiff filed, at respondent's behest, a claim for the refund of about $4,000,000 in taxes which respondent had paid for the year 1942 (R. 262).

The consolidated returns for 1943 were filed on July 15, 1944; those for 1944 on June 15, 1945; and the refund claim on March 9, 1945.

Thereafter, in August 1947, a settlement with the Government resulted in the approval of the 1943 and 1944 returns as filed and in the denial of the refund claim (R. 171-5, 262-3).

Thus respondent, instead of paying more than $21,000,000 in taxes for the period 1942-1944, paid only about $4,000,000. Respondent therefore saved $17,000,000 by using plaintiff's

tax credit (R. 266-7). But plaintiff, whose equity in respondent was wiped out, derived no benefit whatever from this use of its tax credit and the resulting enhancement of respondent's assets.

3. *The anomaly of respondent's retention of the entire tax saving and the denial of any tax benefit to plaintiff.* Normally, the tax credit arising from a stock loss—such as plaintiff's—redounds to the benefit of the party who suffered the loss. This is as it should be, since the tax deduction is designed to mitigate the loss.

Normally, this reasonable result obtains also where a parent corporation, in a consolidated return, deducts its loss from the earnings of a subsidiary. For the tax saving of the subsidiary redounds automatically—through dividends or through the increased value of its stock—to the benefit of the parent which, in an economic sense, owns the subsidiary's assets. Again this accords with the purpose of the tax law which permits consolidated returns in order to give the owners of an affiliated group of corporations the same tax benefits as the owners of a corporation doing business through various departments (see *infra*, pp. 19-21).

But this automatic achievement of the purpose of the tax laws completely failed in the present case; for the economic relationship between plaintiff and respondent had been severed; so that plaintiff derived no benefit whatever from any tax savings of respondent. The purpose of the tax laws was thus perverted: The prosperous respondent obtained a wholly gratuitous tax deduction for a loss which it had never suffered; while plaintiff's stock loss remained unalleviated by any tax advantage.

Plaintiff nevertheless had the means to cause the tax benefits to go where, in justice and by the spirit of the tax law, they belonged, namely, to plaintiff. For plaintiff had, as a matter of law, a free choice whether or not it would file consolidated returns (R. 1458). Before filing

them, plaintiff's management could have made suitable arrangements with respondent which would have assured plaintiff at least a substantial portion of the tax savings in mitigation of its loss.*

No such arrangements were sought or made. Instead, the tax savings were permitted to remain where they fell—in respondent's hands. This stupendous gift by plaintiff of a gratuitous $17,000,000 benefit to respondent has a simple explanation: The allegiance of plaintiff's officers, directors and attorneys to respondent, and their surrender to respondent's wishes and directions.

4. *The divided allegiance of plaintiff's management and the dominating role of respondent in the tax matter.* During the critical period in which the consolidated returns were filed, plaintiff's officers were actually subordinate employees of *respondent;* they received their entire compensation from *respondent,* none from plaintiff (Pl. Ex. 30, R. 527, 1738).

Thus plaintiff's president, Mr. Curry, was at the same time a vice-president and director of *respondent* (R. 719). Despite these weighty titles, Curry was actually but a chief clerk or office manager (R. 639); he considered himself "merely a signing officer" (R. 641) who signed whatever documents Schumacher (*respondent's* bankruptcy trustee) or Elsey (*respondent's* president) told him to sign (R. 642). Plaintiff's only other officer, Mr. Wienken (R. 1719), was actually a stenographer (R. 648); his successor, Miss Valouch (R. 1719-20), was actually a clerk (R. 530). Each of these three was, during the critical period, employed and paid exclusively by *respondent* (R. 645, 1738), and was subject to the inevitable tug of loyalty to his paymaster.

Plaintiff's board of directors presented, during this critical period, the same picture: A majority of its nine mem-

* Agreements of this type have been repeatedly approved by the Securities and Exchange Commission; see *infra,* p. 23.

bers were employees of *respondent* and received their compensation solely from *respondent,* none from plaintiff (Pl. Ex. 22, R. 1720; R. 1135-9). Among plaintiff's directors were: Respondent's reorganization trustee Schumacher, a telephone operator, a stenographer, three clerks and a lawyer paid by respondent and its trustees.

An important role in the tax matter was played by the attorneys for the parties. Plaintiff's general counsel, Nicodemus and Campbell (constituting the firm of Pierce & Greer), were simultaneously attorneys for *respondent* and its trustees (R. 793). For their services they were paid by *respondent* and its trustees (R. 534-8, 1730-1); but they received no compensation from plaintiff (R. 1723). Respondent's trustees instructed Nicodemus to protect *respondent's* estate in preparing the consolidated returns (R. 543-4).

The firm of Whitman Ransom Coulson & Goetz acted as tax counsel for both plaintiff and respondent (R. 544-7, 556, 1438-41). The firm's compensation, however, was paid solely by *respondent* (R. 548-57); and Mr. Polk (who was, together with Mr. Coulson, the partner in charge of the tax matter) baldly admitted that "my responsibility was to them [respondent] and not to the Corporation [plaintiff]" (R. 1431).

The allegiance of plaintiff's management and lawyers to respondent was strikingly demonstrated in the handling of the tax returns. At every stage, respondent made the decisions; plaintiff's role was confined to the mechanical, unquestioning and uninformed execution of respondent's wishes.

Thus tax counsel's recommendation that consolidated returns be filed was made only to respondent, not to plaintiff (R. 1267-8, 1410-11); plaintiff did not even receive a copy of the tax opinion Mr. Coulson rendered to respondent (Pl. Ex. 54, R. 605-610, 665). On the strength of this advice, and without bothering to consult plaintiff, respondent

simply decided * to use plaintiff's tax credit to eliminate its own taxes (R. 1448). Without so much as asking plaintiff, respondent reversed its tax accruals (R. 873, 1770) and stated that plaintiff "can and will" file consolidated returns in which plaintiff's stock loss "will result in elimination" of respondent's tax liability (Pl. Ex. 20-B, R. 512). The consolidated returns for 1943 were thereupon prepared by respondent's employees, under the supervision of Polk (R. 663); they were then placed before Mr. Curry, the "signing officer"; and Curry did just that: He signed (R. 664). He did so without consulting plaintiff's board of directors, without the advice of independent counsel, without understanding of tax matters, indeed without any thought whatever (R. 664, 808).

Roughly the same procedure was followed in connection with the returns for 1944 and the refund claim for 1942. Again, counsel advised respondent, but not plaintiff (R. 623). Again, the decision was made by respondent, not plaintiff (R. 1449-50). Again, the returns were signed by Curry, the "signing officer". Again, Curry omitted to consult plaintiff's board of directors or independent counsel (R. 666-7).

The same pattern also prevailed in the 1947 tax settlement with the Government. Polk secured a power of attorney from plaintiff (R. 1784) which Curry signed without consulting his board (R. 667-8). Thereafter Polk submitted to the Government a written offer of settlement (R. 171); its terms were approved in advance by *respondent's* board (R. 1429-30); while the thought of consulting plaintiff occurred to no one (R. 1431). Not until two months later did plaintiff's board learn of the settlement offer made in plaintiff's name (R. 1460-1, 1788). Despite the objections of plaintiff's board (R. 1794), Polk renewed his settlement offer (R. 1799); and it was, without advance approval by plaintiff's board, accepted by the Government (R. 174-5).

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* Respondent's decision (R. 1448) was made by Elsey, its president (R. 1251), and by DeGraff, its general auditor (R. 1408).

The evidence thus amply supports these findings of the District Court:

> "It was there [in the supplementary complaint] further alleged that the defendant [i.e., respondent] through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as 'duality of control'" (R. 264).
>
> "* * * there is a preponderance of evidence in favor of the plaintiff's contention of 'duality of control'" (R. 272).

The Previous Proceedings and Decisions Herein

1. *The nature of the action and petitioners' position.* Plaintiff commenced this action in October, 1946 to compel respondent to account for the tax benefits it secured from the use of plaintiff's tax credit. Petitioners, who own about 6.7% of plaintiff's preferred stock (R. 1717) and who had previously brought a stockholders' suit involving the same claim (R. 337, 706-7), were permitted to intervene in this action in April, 1947 (R. 122).

Petitioners intervened principally to demonstrate what plaintiff had theretofore failed to allege: The managerial interlock between the parties and the control of plaintiff's management by respondent's trustees and agents (R. 131-146). These facts, we contended, subjected respondent and its trustees to the duty of according fair treatment to plaintiff in the tax transaction; and since the purpose of the tax laws was to confer a tax benefit on plaintiff—because plaintiff had suffered the loss and because it was the parent of the affiliated group—it would have been fair for plaintiff to obtain at least a substantial portion of the tax savings to be produced by the use of its tax credit. The dual allegiance of its management prevented plaintiff from

seeking and making timely arrangements to that end with respondent or its trustees and enabled respondent to appropriate plaintiff's tax credit to the sole benefit of respondent. A court of equity should therefore allow to plaintiff at least a fair share of the tax saving produced by its tax credit.

2. *The decision of the District Court.* The District Court, by Goodman, D. J., dismissed the action principally on a ground which had been neither urged nor briefed by any of the parties, namely, that respondent's tax "escape" was contrary to law and that equity should not compound this injustice by distributing respondent's illegal gain to plaintiff (R. 265-72). An additional ground was that respondent's reorganization plan eliminated plaintiff's stock interest in respondent and that this provision of the plan would be defeated if plaintiff were permitted compensation for the use of its tax credit arising from the worthlessness of its stock (R. 272-5).

3. *The decision of the Court of Appeals.* The Court of Appeals, by a divided court, affirmed. But the prevailing opinion of District Judge Byrne (R. 2214) completely rejected or ignored the grounds of the District Court (R. 2227-8, fn. 12). Briefly stated, the majority below held that the $17,000,000 should be left with respondent because that result was in accordance with the purpose of the tax laws (R. 2232, 2234); and because plaintiff owed respondent a legal duty to make its tax credit available to respondent through consolidated returns without sharing in the resulting benefits (R. 2233-4). They further held that, despite the managerial interlock between the parties, respondent was under no fiduciary obligation to accord plaintiff fair treatment in the tax transaction (R. 2221-3). The majority below reached these conclusions largely on the basis of federal tax law; partly also as a matter of state fiduciary law—although they failed to cite a single state court decision or even to determine which of the several state laws having contact with the case they deemed applicable (see

infra, p. 29). In order thus to affirm the District Court's decision upon theories not considered or adopted by that Court, the majority below made numerous totally new findings of fact (see *infra*, p. 24); and they held that such procedure was consonant with Rule 52(a) F. R. C. P. (R. 2236).

Judge Fee dissented (R. 2239). He likewise rejected the District Court's grounds (R. 2240-1), but held that the absence of fact findings by the District Court pertinent to the new grounds of decision was alone sufficient to require reversal (R. 2241-2, 2249-50). He further held that "plaintiff had no duty requiring it to file these returns" (R. 2243) and "no duty to apply the loss for the benefit of defendant" (R. 2251). Plaintiff, he held, "had a property right to file or refuse to file consolidated returns" (R. 2242); he denied that "the officers of plaintiff could give away [this] property right" (R. 2244) unless there "be findings that there was adequate consideration" (R. 2245). He concluded that "therefore the actual cash benefit obtained by defendant by use of losses of plaintiff might well be compensated by award of an equitable portion of the tax remission which the United States allowed on account thereof" (R. 2242-3).

Petitioners applied for rehearing en banc; but the same majority below struck the petition as unauthorized by law or practice (R. 2260). Judge Fee dissented because the decision of "this serious and important litigation", involving "novel statutory language affecting the fields of bankruptcy and taxes", should not rest upon the "three widely divergent views" expressed by three district judges (R. 2261).

The full bench of the Court below thereafter refused to consider rehearing en banc because the division had "authoritatively" denied it (R. 2288, 2296). Denman, Ch. J., dissented and voted to grant rehearing en banc (R. 2296, 2307).

4. *The decision of this Court.* Petitioners applied for certiorari both because of the substantive errors of the Court below and its "en banc" proceedings. This Court granted certiorari without qualification as to the issues to be reviewed (344 U. S. 809; see 345 U. S., at 250). The majority opinion of this Court (per Vinson, Ch. J.) did not, however, reach the substantive controversy; it vacated the order below striking the "en banc" petition because the Court below had failed to pass on the merits of that petition (345 U. S. 247). Mr. Justice Frankfurter concurred in a separate opinion.

Mr. Justice Jackson dissented on the ground that the "en banc" proceedings below should not be disturbed. Reaching thus the substantive issues, he held that the decision below should be reversed on the merits. Plaintiff, he held, had "the right, but no legal duty, under federal law to join in consolidated returns". The purpose of the statutes permitting plaintiff's loss to be offset against respondent's profits probably "was to provide salvage for the loser, not profit for one which sustained no loss". Plaintiff would have been morally and legally justified in bargaining for a fair share of the tax savings; and since the parties were "subject to considerable, if not complete, common control", plaintiff was "entitled to what fair arm's length bargaining would probably have yielded" (345 U. S., at 276-7).

5. *The decisions of the Court of Appeals after remand.* After amendment of its Rule 23 (R. 2353), the Court below, sitting en banc, referred the petition for rehearing en banc to the division which had originally heard the appeal (R. 2354). In a concurring opinion (R. 2359), Denman, Ch. J., intimated that he considered the case as "of such significance that it deserves the attention of the court en banc"; and he referred to the "very intricate" issues, the "stupendous" amount involved and this Court's previous grant of certiorari "on the merits as well as on the question of

rehearings en banc". Judge Pope dissented and voted to rehear the case en banc; he pointed to the "important" character of the litigation, the "novel point of law" involved, and the equal division of opinion between the four appellate judges who had considered the merits (R. 2356-7).

Thereupon two judges of the original panel below, in an opinion by Judge Healy, denied the petition for rehearing en banc (R. 2363). They did so without benefit of the views of Judge Fee who "did not participate in this determination" (R. 2373). In response, however, to Mr. Justice Jackson's opinion, the majority below proceeded to restate and expand their earlier grounds for dismissal, invoking principles of bankruptcy and federal judicial power. Thus they held that plaintiff's claim should be rejected because plaintiff was the former parent of the bankrupt respondent whose unpaid creditors had acquired their claims at a time when plaintiff owned and controlled respondent (R. 2368-9); because the final order in respondent's reorganization excluded all claims of its former stockholders (R. 2372); because plaintiff did not present its claim to the bankruptcy court (R. 2372); and because, in any event, the bankruptcy court would not have permitted plaintiff to bargain for a share in respondent's tax savings (R. 2370, 2372). Finally the majority below held, contrary to Mr. Justice Jackson, that it was beyond the judicial power of a federal constitutional court to determine "what fair arm's length bargaining would probably have yielded" (R. 2373).

Questions Presented

1. Are the federal tax statutes which permit, in consolidated tax returns, a parent corporation's stock loss to be offset against the subsidiary's profits, designed for the benefit of the parent or the subsidiary?

2. Under federal tax law, is a parent corporation with a tax loss entitled, but free of any duty, to join in con-

solidated tax returns with its profitable subsidiary in order to minimize the latter's taxes?

3. Does a Court of Appeals have power to make new findings of fact where the District Court has made none or has made contrary findings?

4. Did the Court below unduly depart from the accepted and usual course of appellate proceedings by deciding questions of state law (regarding the fiduciary relations and duties between the parties) without determining the applicable state law, although the case has important contacts with three state jurisdictions and the laws of each of the three states are contrary to the holdings below?

5. Where a transaction between two corporations is unilaterally advantageous to one of them although the two companies are, because of their interlocking managements, obligated to deal fairly with each other, is it beyond the judicial power of a federal constitutional court to determine what fair arm's length bargaining would probably have yielded?

6. Where a former subsidiary corporation and its reorganization trustees appropriate the former parent's tax credit, arising from the worthlessness of its stockholdings in the subsidiary, is the parent's claim to a fair share of the tax benefits precluded by the subsidiary's reorganization plan which eliminates the parent's stock interest in the subsidiary?

7. Is, upon these facts, the parent's claim precluded by the parent's failure to present it to the bankruptcy court, although the former subsidiary, upon emerging from the reorganization, assumed all obligations of its reorganization trustees?

Reasons for Granting the Writ

In this "serious and important litigation" (R. 2261), this Court's previous grant of certiorari (344 U. S. 809) was unqualified and unrestricted; the "en banc" question was to be reviewed only "among other things" (345 U. S., at 250). All of these other questions which were then deemed worthy of review are now presented again; and added to them are the new issues of bankruptcy law and federal judicial power raised by Judge Healy's recent opinion. This Court's previous allowance of the writ furnishes a persuasive precedent for this petition.

The federal questions presented are, indeed, not only "novel" and "intricate" (R. 2261, 2361), but of far-reaching importance; and on numerous points the decision below is in conflict with holdings of this Court and other Courts of Appeals.

1. Thus the majority below held that a parent (or former parent) with a large tax credit owes a legal duty to its profitable subsidiary to file consolidated returns in order to minimize the subsidiary's taxes (R. 2233-4, 2369). That is contrary not only to the holdings of Mr. Justice Jackson and Judge Fee, but in direct conflict with *Duke Power Co.* v. *Commissioner*, 44 F. 2d 543, 545 (C. C. A. 4, 1930), cert. den. 282 U. S. 903:

> "It [Congress] assumed that if there was that degree of affiliation which the law required [for consolidated returns] there was dominant control, and it gave to that dominant control [i.e., the parent] the right to make the choice [i.e., between consolidated and separate returns]. * * * If its [a corporation's] stockholders decide that its best interests require filing by it of a separate tax return, no provision of the law denies it this privilege * * *."

The Court below further held that the purpose of the tax laws was to confer a tax benefit on the profitable sub-

sidiary, respondent, rather than on the parent, plaintiff, which suffered the loss; hence respondent should retain the entire tax saving. Mr. Justice Jackson and Judge Fee held otherwise; and we shall show that the Court below misconstrued the purpose of the tax laws, contrary to the expressed Congressional intent and the rulings of this Court. The error below on this critical issue of federal law justifies the granting of certiorari; see *Phillips-Jones Corp.* v. *Parmley*, 302 U. S. 233 (1937).*

The tax statutes involved in these rulings below, I. R. C., §§ 23(g)(4) and 141, are in continued effect today as they have been since 1942 (contrary to a perhaps inadvertent statement in Mr. Justice Jackson's opinion). If the holding below should stand unreviewed, it is fair to predict a flood of litigations by subsidiaries or their stockholders against parent corporations for their failure to minimize the subsidiaries' taxes through consolidated returns. Indeed, at least one such litigation invoking the decision below as controlling authority is now pending in the New York Supreme Court (*Hirsh* v. *McAuliff*, N. Y. Co., No. 18648/1951). More than that: Whenever a parent corporation is hereafter faced with a choice of filing consolidated or separate returns—and that will happen each year in many thousands of instances—the decision below will cast a cloud of uncertainty and risk upon the management's freedom of choice. The decision below would destroy the parent corporation's privilege of choosing between consolidated and separate returns. If that be the law, it should at least be announced by this Court.

2. The Court below premised its judgment upon findings of fact made by it, not by the trial court. In the face of

* In that case, a stockholder of a dissolved corporation, having been forced to pay the corporation's taxes, asserted an equitable right to contribution against the other stockholders. The lower court denied contribution as contrary to the scheme of the tax laws. This Court granted certiorari because there was nothing in the tax laws to preclude the equitable remedy of contribution (302 U. S., at 235).

Judge Fee's criticism, the majority below insisted upon its right so to proceed (R. 2236), contrary to *Kupperman* v. *M. & J. Becker, Inc.*, 198 F. 2d 765, 770 (C. A. 2, 1952), and numerous other decisions of this Court and other Courts of Appeals. This highly prejudicial procedure, based on an unprecedented extension of the appellate powers of Courts of Appeals, requires review (Sup. Ct. Rule 38(5)(b)); see *Oil Shares, Inc.* v. *Commercial Trust Co.*, 304 U. S. 551 (1937), where this Court granted certiorari and simultaneously reversed and remanded to the District Court for appropriate findings.

3. The Court below also decided questions of fiduciary law without first determining the applicable state law, without citation or discussion of any local law whatever and in fact contrary thereto, all in disregard of the rule of *Griffin* v. *McCoach*, 313 U. S. 498, 503-4 (1941), and *Klaxon Co.* v. *Stentor E. M. Co.*, 313 U. S. 487 (1941).

4. The Court below refused to correct an inequitable transaction between fiduciary and cestui because it deemed a determination of what fair arm's length bargaining would probably have yielded to be beyond the judicial power of a federal constitutional court. Such doctrine would deal a death blow to the equitable powers which federal courts have wielded for more than a century; *Ewen* v. *Peoria & E. R. Co.*, 78 F. Supp. 312, 317 (D. C., S. D. N. Y., 1948, per Learned Hand, J.), cert. den. 336 U. S. 919. Review by this Court would seem imperative.

5. The Court below held that plaintiff's claim to a share in the tax savings produced by its tax credit would be contrary to the rights of respondent's unpaid creditors; and that the order of the bankruptcy court eliminating plaintiff's stock interest in respondent also eliminated plaintiff's right to compensation for the use of its tax credit. This meant, in effect, that the stockholder of a bankrupt corporation must not only subordinate its stock interest to the

claims of the creditors, but must surrender its own assets —here, its tax credit—for the satisfaction of the creditors in bankruptcy.

Equally untenable is the holding below that plaintiff forfeited its claim by not presenting it to the bankruptcy court. The claim arose from the appropriation of plaintiff's tax credit by respondent and its trustees. Even during respondent's reorganization plaintiff had the statutory right to assert this claim in any court of competent jurisdiction; § 66 of the (old) Judicial Code, 28 U. S. C. § 125 (old); *Texas & P. R. Co.* v. *Johnson,* 151 U. S. 81, 101 (1894). It had the same right after respondent emerged from reorganization and assumed all obligations of the trustees; *Chicago G. W. R. Co.* v. *Hulbert,* 205 Fed. 248, 250-1 (C. C. A. 8, 1913); *American Brake S. & F. Co.* v. *Pere Marquette R. Co.,* 263 Fed. 237, 240 (D. C., E. D. Mich., 1920).

In urging these reasons for certiorari, we are mindful of the need for brevity; we shall therefore present our arguments as succinctly as the problems in this "difficult and complicated litigation" (per Vinson, Ch. J.) will permit.

POINT I

The Court of Appeals erred in holding that the purpose of the tax law was to benefit respondent rather than plaintiff, and that plaintiff was under a duty to file consolidated returns for the sole benefit of respondent.

The Court below saw no reason why a tax saving "should inure to the benefit of the parent company or of the company which has sustained the loss that makes possible the tax saving" (R. 2232). On the contrary, it found plaintiff under a "duty not to attempt to appropriate to itself an advantage which the tax laws give the subsidiary" (R.

2369); so that plaintiff's officers acted properly in permitting "the tax advantage to fall where the tax laws ordained" (R. 2371), i.e., in respondent's pocket. These crucial holdings rest on a fundamental misconception of the purpose and operation of the tax statutes here involved.

1. When Congress, in 1942, allowed the worthlessness of stock in an affiliate as a deduction against ordinary income (§ 23(g)(4)), its purpose was obvious: Congress wished to mitigate the economic impact of such stock loss by the resulting tax saving. The decision below subverts this purpose; for the stock loss was suffered by plaintiff, while respondent was permitted to retain the tax saving. Since plaintiff and respondent were economic strangers, respondent's tax saving could not mitigate plaintiff's loss.

2. The holding below also flies in the face of uniform authority establishing that consolidated returns are designed for the benefit of the parent, not of the subsidiary. The rationale of consolidated returns

> "is the recognition of [the] common owner's right to set off against his gains in the one [corporation] his losses in the other [corporation] * * *".
>
> *Duke Power Co.* v. *Commissioner, supra* (44 F. 2d, at 545).

Or, as authoritatively stated in the *Report of the Senate Finance Committee,* 70th Cong., 1st Sess., S. R. 960, p. 14 (1928):

> "The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. * * * The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single

> business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every one of its agencies."

To assure that the consolidated group is "in reality one and the same business", Congress required that the parent own 95% of the stock of its subsidiary, on the assumption that this would assure economic unity. See *Senate Committee Report, supra:*

> "Much of the misapprehension about consolidated returns will be removed when it is realized that it is only when the corporations are really but one corporation that the permission to file consolidated returns is given, and that no ultimate advantage under the tax laws really results. The present law permits the filing of consolidated returns only where one corporation owns at least 95 per cent of the stock of the other corporation or if a least 95 per cent of the stock of both corporations is owned by the same interest. The provision embodies the business man's conception of a practical state of facts."

And this Court in *Atlantic City E. Co.* v. *Commissioner,* 288 U. S. 152, 154 (1933):

> "The requirement of consolidated returns was 'based upon the principle of levying the tax according to the true net income and invested capital of *a single business enterprise,* even though the business is operated through more than one corporation.' Treasury Regulations No. 45, Art. 631." (Italics added.)

Thus the purpose of consolidated returns was simply to give the "common owner" (*Duke Power* case, *supra*) of an affiliated group of corporations the same tax benefits as the owner of a corporation operating through various departments. In both cases the intended beneficiary is neither the department nor the subsidiary, but the "common owner" of the business, i.e., the parent and its stock-

holders. Hence, neither the department nor the subsidiary, if it operates profitably, has any ground in its own person to seek a reduction of its taxes, even though another department or another subsidiary has sustained a loss. But the parent (the common owner) is permitted to do so because, in an economic sense, the profits and losses of each department or subsidiary are actually the profits and losses of the parent.

Hence the right to offset such losses and profits against each other in consolidated returns is the parent's right, created in its interest and for its benefit; any advantage flowing to the subsidiary is merely incidental and the fortuitous means by which the parent obtains its intended advantage.

The Court below, without even mentioning any of these authorities, reached the diametrically opposite conclusion that the tax laws intended to give all of the tax savings here involved to respondent (the subsidiary) and none to plaintiff (the parent). It predicated this result on a fragmentary analysis of two provisions of the tax law:

(a) The subsidiary, like the parent, may prevent the filing of consolidated returns by its refusal to consent thereto (R. 2230; I. R. C., § 141(a); Treas. Reg. 104, § 23.12). But the right of the parent, which alone can file consolidated returns, to refuse to do so is not comparable to the subsidiary's right of refusal. The parent's right is given in furtherance of the statutory intent that the parent, as the "common owner", should enjoy the benefits if it so desires. But the subsidiary is obviously not the "common owner" of the group; its consent is required only: (1) To assure uniform action by the entire affiliated group; and (2) To assure that the subsidiary is legally bound by the parent's election (otherwise the subsidiary might, e.g., deny its joint and several liability for the consolidated taxes, Treas. Reg. 104, § 23.15(a)). Since in the normal situation of economic unity between parent and subsidiary

—and that is the situation contemplated by the statute—the parent's power of control will enable it to guide the subsidiary, the requirement of the subsidiary's consent does not indicate that consolidated returns are intended for the benefit of the subsidiary.

(b) Equally unfounded is the reliance by the Court below on those provisions of the tax law which permit consolidated returns for a past period of affiliation although, at the time of filing, the affiliation has ended (R. 2230-1; see Treas. Reg. 104, § 23.12(e)). In these cases there exists no "economic unity" between the ex-parent and the ex-subsidiary at the time the consolidated returns are filed; and the ex-parent cannot derive any automatic benefit (through dividends or increased value of the ex-subsidiary's stock) from the tax savings of the former subsidiary. From these rather anomalous situations the Court below deduced that consolidated returns do not "require" economic unity and are not intended for the benefit of the parent (R. 2230-1).

The trouble with this argument is that it confuses the "requirements" of the statute with its "purpose". We never contended that the consolidated returns statute "requires" economic unity; we do contend that it "contemplates" economic unity; the authorities so hold. It is true enough that the statute requires no more than 95% stock ownership; but the statute makes this requirement on the theory that, by and large, corporations inter-connected by 95% stock ownership "are in reality one and the same business", "a single business" (*Senate Report, supra*). It is true that in a few anomalous situations the requirements of the statute can be fulfilled, although there is no economic unity; but the purpose of the statute nevertheless remains the same, namely, to grant relief to the parent as the common owner of the affiliated group.

The Court below thought that in those exceptional cases where the economic unity has been severed, "any benefits to the subsidiary obviously cannot inure to the parent"

(R. 2230). But that is not so. Since only the ex-parent can file consolidated returns, its self-interest will determine whether or not it should do so. The ex-subsidiary will likewise give or withhold its consent to consolidated returns according to its self-interest. In short, the filing or nonfiling of such returns and the sharing in the benefits therefrom may well be the subject of negotiation between ex-parent and ex-subsidiary and may well result in the sharing by both corporations. Moreover, where the parent voluntarily terminates the affiliation, it can assure itself the benefit of the subsequent filing of consolidated returns. Thus, if the parent sells its 95% stock interest in a subsidiary to a stranger knowing that its loss will, in a consolidated return, confer a $17,000,000 tax saving on the subsidiary, can it be doubted that this will be reflected in the price of the stock being sold?

By the same token, the purpose of the tax laws could not be automatically effected by the consolidated returns in the case at bar. Although plaintiff was the parent, its normal and automatic benefit from the tax saving of its subsidiary, the respondent, could not occur; for the shares of respondent, held by plaintiff, were merely pieces of paper representing neither equity nor right to dividends. Hence, the statutory purpose could be effected only in another fashion, namely, by an agreement between the parties allocating the resulting tax savings.

Agreements of this type are clearly envisaged by Treas. Reg. 104, § 23.15(a) and (d). They are a familiar device and have received administrative sanction. *Consolidated Electric & Gas Co.*, 15 S. E. C. 161 (1943); *Islands Gas & Electric Co.*, 13 S. E. C. 649 (1943); *Cities Service Co.*, 17 S. E. C. 839 (1944). In each of these cases affliated utility companies had filed consolidated returns; in each the company contributing a loss, and thereby reducing the taxes of its other affiliates, received compensation from them for the use of its tax credit; in each the S. E. C., pursuant to its Rule U-45(b)(6),* approved this arrangement

as fair and reasonable. In the case at bar, the need for a similar arrangement was much greater than in the three S. E. C. cases; for there, the consolidated group was an economic unit so that tax saving payments were merely a matter of expedience; whereas here, with the economic unity destroyed, such payments were a matter of necessity to achieve the purpose of the tax laws.

The Court below erred therefore in holding that the tax laws were intended to benefit respondent rather than plaintiff. And since this holding was the premise on which the Court below concluded that it was fair for respondent to retain all its tax savings produced by the use of plaintiff's tax credit, we submit that the conclusion must fall along with the premise.

POINT II

The Court of Appeals erred by making findings of fact where the District Court had made none, or had made contrary findings.

The Court below predicated plaintiff's duty to file consolidated returns not only upon the purpose of the tax laws, but upon the fiduciary relation between the parties. Its reasoning, however, is a tangled web of findings of fact which the Court—erroneously, we believe—made *de novo*, and of purported rules of fiduciary law contrary to all applicable local authorities. It will be helpful to show, first, the improper factual premises on which the Court below proceeded, and thereafter (Point III, *infra*) the legal conclusions it drew therefrom.

1. Of the numerous fact findings which the Court of Appeals made on its own authority—unsupported by, or

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* 17 C. F. R. (1949), § 250.45(b)(6); see *infra*, Appendix.

contrary to, the findings of the trial court—we cite but a few.

(a) The Court below found the record "barren of evidence" to support our contention that respondent dominated plaintiff in the tax transaction (R. 2235). This pivotal finding was contrary to the finding of the District Court (quoted *supra*, p. 9) that there was a "preponderance of the evidence" showing that respondent "had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant" (R. 264, 272). We have previously shown that the evidence amply supports this finding of the District Court (*supra*, pp. 6-8).

(b) The Court below found that plaintiff's officers, in filing consolidated returns, "were conforming with the policy and directions of the Corporation" (R. 2229). The District Court did not so find; and the record shows, without contradiction, that plaintiff's board of directors was not consulted about the filing of consolidated returns for the critical years (R. 1018).

(c) The Court below found that the interlock between the managements of plaintiff and respondent had been created by plaintiff (R. 2223, 2369). The District Court did not so find. During respondent's reorganization its personnel was, of course, appointed by the bankruptcy court; after the reorganization they were appointed by respondent's new stockholders and directors. Neither during nor after respondent's reorganization was plaintiff in a position to appoint respondent's personnel.

(d) The Court below found that, in each year from 1916 to 1942, the corporations forming the Western Pacific group had filed consolidated returns; and that in none of those years did the companies contributing a loss receive "tribute" for doing so (R. 2225, 2233, 2370-1). The Dis-

trict Court did not so find; * and the record establishes that in several instances an affiliate contributing a loss was indeed paid therefor (Price Waterhouse report, Def. Ex. 40, not printed pursuant to order, R. 2176).

(e) The Court below found that the firm of Whitman Ransom Coulson & Goetz were "independent tax experts" (R. 2226). The District Court, far from finding this firm "independent", referred to them as "the tax attorneys for defendant" (R. 261, 265); and their bias for respondent is established by the uncontradicted evidence (*supra*, p. 7). Similarly, in discussing Mr. Nicodemus, the Court below selected only the evidence purportedly showing his loyalty to plaintiff (R. 2370), but completely passed over the undisputed fact that Nicodemus was paid solely by respondent and its trustees and was instructed by them to protect respondent's interest in the tax matter (*supra*, p. 7).

We refrain from citing additional instances. Each of the findings of the Court of Appeals which we have listed was important to its decision; each was unsupported by any finding of the District Court; each was contrary to the clear evidence.

2. In adopting this course, the majority below did not act casually or inadvertently, but purported to lay down a broad principle of appellate power and procedure. In the face of Judge Fee's detailed criticism (R. 2239, 2241-2, 2249-50), the majority below held that findings of fact are merely "intended to aid appellate courts", and that they "are not a jurisdictional requirement of appeal which this court may not waive" (R. 2236).

The holding below, we submit, was contrary to Rule 52(a) and (b) F. R. C. P. which entrusts the task of fact

* The District Court did find that the consolidated taxes were allocated among the various subsidiary companies having taxable income in proportion to the amount of such taxable income (R. 261). But the District Court did not find that there were no payments to other companies contributing a loss.

finding to the trial court, not the appellate court. It was also contrary to the holdings of this Court and other Courts of Appeals. Thus the court in *Kupperman* v. *M. & J. Becker, Inc.*, 198 F. 2d 765, 770 (C. A. 2, 1952), although finding the evidence "abundantly clear", nevertheless remanded because "We cannot * * * make the necessary finding since as an appellate tribunal we are without the power to do so". Accord: *Kelley* v. *Everglades Drainage District*, 319 U. S. 415, 421-2 (1943); *McClure* v. *O. Henry T. & A. Co.*, 184 F. 2d 636, 639 (C. A. 7, 1950).

The majority below invoked three decisions as supporting its power to make new findings (R. 2236). None of them is in point. Indeed in *Mayo* v. *Lakeland H. C. Co.*, 309 U. S. 310 (1940), this Court reversed the lower court because of the insufficiency of the District Court's fact findings; it held that "fair compliance with Rule 52(a)" was "of the highest importance to a proper review" (p. 316); and it remanded with directions that "any action taken by the court shall be upon findings of fact and conclusions founded upon the evidence, in accordance with Rule 52(a)" (p. 319).

In *Goodacre* v. *Panagopoulos*, 110 F. 2d 716 (App. D. C., 1940), the trial court had embodied its findings in a memorandum opinion instead of making "separate findings" of fact; the Court of Appeals merely held that it need not reverse "for a mere formal failure to comply with the rule" (p. 718).

In *Hurwitz* v. *Hurwitz*, 136 F. 2d 796 (App. D. C., 1943), the court did hold that findings of fact by the trial court are "not a jurisdictional requirement of appeal which this court may not waive" and that their purpose is merely "to aid appellate courts in reviewing the decision below" (p. 799). Whether or not the *Hurwitz* decision was correct when it was made in 1943 need not be debated. It certainly has lost its vitality since the 1946 amendment of the Federal Rules of Civil Procedure. The *Committee Note of 1946 to Rule 52(a)* states:

> "Findings of fact aid in the process of judgment and in defining for future cases the precise limitations of the issues and the determination thereon. Thus they not only aid the appellate court on review (*Hurwitz* v. *Hurwitz* (App. D. C. 1943), 136 F. 2d 796), but they are an important factor in the proper application of the doctrines of res judicata and estoppel by judgment."

The *Hurwitz* rule that findings are merely designed to aid the appellate court was thus rejected; and with the elimination of that premise, the conclusion that an appellate court may waive findings of the trial court and make its own findings must equally fall. The weight to be accorded to the Committee Notes is, of course, well recognized; *Mississippi Pub. Co.* v. *Murphree,* 326 U. S. 438, 444 (1946).

We submit, therefore, that the Court of Appeals erred in making its own findings; and the Court compounded the error by making findings which were contrary to those of the District Court and contrary to the evidence.

POINT III

The Court of Appeals erred in determining the fiduciary relations and duties between the parties without determining the applicable local law and, indeed, contrary to local law.

The majority below held plaintiff to be respondent's fiduciary, merely because of its ownership of respondent's worthless stock. It rejected our contention that *respondent* owed plaintiff the fiduciary duty of fair treatment in these tax transactions; interlocking management, said the Court, absent domination and control, does not give rise to a fiduciary relation. The Court then assumed, *arguendo,* that respondent was obligated to deal "fairly" with plaintiff; but it held that there was fairness because plaintiff had suffered no damage.

1. The Court below erred in not determining the applicable state law.

The Court below recognized that it "must look to the law of corporations to determine whether the subsidiary [respondent] stood in a fiduciary relation to Corporation [plaintiff]" (R. 2221-2). But the Court failed to determine which state law it deemed applicable. There was need to do so since plaintiff is a Delaware corporation with its office in New York; respondent is a California corporation likewise maintaining an office in New York; and the consolidated tax returns were prepared, signed and filed in New York (R. 6, 12, 643, 659, 661, 666). Contrary to the precept of *Klaxon Co.* v. *Stentor E. M. Co.*, 313 U. S. 487 (1941), the Court omitted to consult the applicable conflict of laws rules of California.

Even more grievous is the Court's total failure to cite a single New York, Delaware or California decision in support of its rulings. It preferred to formulate its own views of the mutual fiduciary duties of affiliated corporations. This Court condemned such procedure in *Griffin* v. *McCoach*, 313 U. S. 498, 503-4 (1941). The lower court there had pronounced its view of the applicable state law without the citation of any authorities. This Court held:

> "But this is something to be decided according to Texas decisions to none of which the opinion refers. [Citing cases.] The decision must be reversed and remanded to the Circuit Court of Appeals for determination of the law of Texas as applied to the circumstances of this case."

2. The Court below erred in holding plaintiff to be respondent's fiduciary.

The majority below so held solely because plaintiff "was the sole owner of the subsidiary's capital stock" (R. 2234). Clear beyond cavil is the contrary rule of law: Naked stock ownership creates no fiduciary duty unless the parent dominates or controls the subsidiary. *Southern Pacific*

Co. v. *Bogert,* 250 U. S. 483, 492 (1919); *Blaustein* v. *Pan American P. & T. Co.,* 263 App. Div. 97, 119 (1941), aff'd 293 N. Y. 281 (1944); *Allied Chemical & Dye Corp.* v. *Steel & Tube Co.,* 14 Del. Ch. 1, 12-13, 120 Atl. 486 (1923); *Title Ins. & T. Co.* v. *California Dev. Co.,* 171 Cal. 173, 205-6, 152 Pac. 542 (1915); 13 *Fletcher, Corporations* (1943), § 5811, pp. 127-8. The Court below conceded that during the critical period respondent "was no longer controlled by Corporation [plaintiff] but by the trustees appointed by the bankruptcy court" (R. 2223). The holding below that plaintiff was the fiduciary of respondent was thus wholly unfounded.

3. The Court below erred in holding that respondent owed plaintiff no fiduciary duty of fair treatment in the tax transactions.

Having rejected—improperly, we say—the District Court's finding that respondent controlled plaintiff, the Court below had to deal with the effects of the managerial interlock between plaintiff and respondent. The Court conceded that "there obviously existed an interlocking management" (R. 2223); but it held, nevertheless, as a matter of law, that the "mere fact of officers and directors in common does not create such a fiduciary relationship" (R. 2222). No authority is cited for this amazing proposition.

The contrary, we submit, is a rule of universal application. *Geddes* v. *Anaconda Copper Mining Co.,* 254 U. S. 590, 599 (1921), states the classical and most frequently cited formulation of the doctrine:

> "The relation of directors to corporations is of such fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation; and where the fairness of such transactions is challenged, the burden is upon those who would maintain them to show their entire fairness; * * *. This court has been consistently emphatic in the

application of this rule, which, it has declared, is founded in soundest morality and, we now add, in the soundest business policy."

The rule is the same in New York, in Delaware, in California and, indeed, throughout the land. *Chelrob* v. *Barrett,* 293 N. Y. 442, 460-2, 57 N. E. 2d 825 (1944); *Keenan* v. *Eshleman,* 23 Del. Ch. 234, 243-4, 2 Atl. 2d 904 (S. Ct., 1938); *Title Ins. & T. Co.* v. *California Dev. Co.,* 171 Cal. 173, 205-6, 152 Pac. 542 (1915); *Mayflower Hotel S. P. C.* v. *Mayflower Hotel Corp.,* 173 F. 2d 416, 418-423 (App. D. C., 1949, with numerous references).

The rule rests on "the ancient precept against serving two masters", *Pepper* v. *Litton,* 308 U. S. 295, 311 (1939), a principle as old as Holy Writ, "infallible and hallowed", *Alexander* v. *Theleman,* 69 F. 2d 610, 613 (C. C. A. 10, 1934). Just as there is danger that a director dealing with his corporation will favor his personal interest, so in transactions between interlocking corporations "the danger to be avoided is that a director or group of directors, common to two corporations, may, for reasons of self-interest, favor one of the entities in its dealings with the other"; *Mayflower* case, *supra,* 173 F. 2d, at 420. Hence courts impose "the most careful scrutiny of transactions between the corporations represented by common directors, to the end that, in the absence of arm's-length bargaining, the scales may not, even through mistake or inadvertence, be unfairly tipped to one side or the other"; *Chelrob* v. *Barrett, supra,* 293 N. Y., at 461.

The Court below totally ignored all of these authorities; and it failed to cite any state authorities of its own.* We

* The only state authorities cited below (R. 2371) are *Shelley* v. *Board of Trade,* 87 Cal. App. 344, 264 Pac. 403 (1927), and *McMillan* v. *O'Brien,* 219 Cal. 775, 29 P. 2d 183 (1934). Neither of them involved any fiduciary law or relations. The courts held that an executed voluntary transfer of property by an individual is valid without consideration. That may be true where, as in those cases, the parties dealt at arm's-length. It is obviously not true where the common officers of two corporations cause one to make a $17,000,000 gift to the other.

submit therefore that the Court below erred in holding respondent to be free of any fiduciary duty to deal fairly with plaintiff in the tax transactions.

4. The Court below erred in holding that respondent accorded plaintiff fair treatment.

The Court below held that, even if respondent was obligated to deal fairly with plaintiff, it had not breached this duty. Fairness, said the Court, required no more than that respondent should not sacrifice plaintiff's interests to its own (R. 2232). And there was no such "sacrifice" because plaintiff, poor and without income, could not use its tax credit to create tax savings for itself (R. 2232-3).

Plaintiff's alleged inability to use its tax credit is just another "fact" found by the Court of Appeals without any supporting finding of the District Court. Although plaintiff had no income of its own, it had other means of utilizing its tax credit; see *Alprosa Watch Corp.* v. *Commissioner*, 11 T. C. 240 (1948).

But wholly apart from these possibilities, the very fact that plaintiff's tax credit was useful to respondent made it a valuable asset of plaintiff. Plaintiff and respondent each had an essential ingredient for achieving a tax benefit. They joined their resources to produce the tax benefit; but only one, the fiduciary, respondent, retained all the profit while plaintiff, its cestui, received none. Can this result possibly be called fair dealing by a fiduciary with its cestui?

In the words of Mr. Justice Jackson:

> "It may seem anomalous at first glance that a sustained loss can be realized upon as an asset. But it is not the loss; it is the right to use the loss as an offset that is valuable. The market for it is restricted, of course, but this detracts nothing from its value to one in a position to utilize it. * * * I know of no moral or legal obligation to give away any legal opportunity or advantage just because its owner cannot utilize it himself."

The argument of the Court below that "after the transaction Corporation was in exactly the same position that it was in before" (R. 2233), implies that plaintiff cannot recover because it did not suffer actual injury. The Court does not reveal upon which local law it predicates the necessity of injury. The law is well settled that a fiduciary dealing unfairly cannot escape an accounting on the ground that the cestui suffered no detriment. Thus in *Leslie* v. *Commercial Nat. Bank in Shreveport,* 28 F. Supp. 927, 933 (D. C., W. D. La., 1939), aff'd sub nom. *Commercial Nat. Bank in Shreveport* v. *Parsons,* 144 F. 2d 231, 236-7 (C. C. A. 5, 1944), the fiduciary was held liable "regardless of whether the principal had suffered injury or not". In *Fleishhacker* v. *Blum,* 109 F. 2d 543, 546 (C. C. A. 9, 1940), a bank officer was held accountable for the breach of his fiduciary duty "even though the bank has suffered no damage". And see *Restatement, Restitution* (1937) § 1, Comment (e), pp. 14-15; § 197, Comment (c), pp. 809-810.

We submit that respondent was obligated to accord plaintiff fair treatment in the tax transaction; and that respondent acted less than fair by retaining all and allowing plaintiff none of the resulting benefits.

POINT IV

The Court of Appeals erred in holding that it is beyond the judicial power of a constitutional Court to determine what fair arm's length bargaining would probably have yielded plaintiff.

Mr. Justice Jackson held that "plaintiff is entitled to what fair arm's length bargaining would probably have yielded". The Court below rejected this holding because "Bargaining presupposes negotiations" and "Such activity is a matter of business administration, and is not a judicial function" within the province of a "constitutional court" (R. 2373).

The short answer is that constitutional courts have, since time immemorial, performed this very function. In *Chelrob* v. *Barrett, supra* (293 N. Y. 442), and in *Marian* v. *Mariani,* 276 App. Div. 205, 93 N. Y. S. 2d 370 (1949), one affiliated corporation had sold its property to another at an inadequate price; the court had no trouble in determining the amount of the "fair" price and in requiring the purchaser to pay it to the seller. In *Ewen* v. *Peoria & E. R. Co.,* 78 F. Supp. 312 (D. C., S. D. N. Y., 1948), cert. den. 336 U. S. 919, the problem was the "fair" division of income and expenses between two jointly operated railroads feeding traffic to each other, both companies being under identical management. Judge Learned Hand held that the court "should fix the terms of any transactions between the two as though each had in fact exerted its bargaining power against the other at arm's length" (p. 317); and he showed how, in a difficult situation, this requirement can be met.

The holding below, we submit, presents a novel and unjustified limitation upon the equitable powers of a "constitutional court". The holding should not be permitted to stand as a precedent without first being reviewed by this Court.

POINT V

The Court of Appeals erred in holding that plaintiff's claim is precluded by the order of the bankruptcy court eliminating plaintiff's stock interest in respondent or by plaintiff's failure to present its claim to the bankruptcy court.

1. Respondent's reorganization plan (233 I. C. C. 409) eliminated plaintiff's stock interest in respondent; and the final order of the bankruptcy court accordingly provided that the assets of the reorganized respondent were to be free and clear of all claims of its former stockholders (R. 2014). Both the District Court and the Court of Appeals

held that these provisions were incompatible with plaintiff's present claim to a share in respondent's tax savings (R. 272-5, 2372). For a "saving" in taxes, it was held, actually means earnings not paid out to the Government; plaintiff's claim is therefore a demand for a share of respondent's earnings; and the assertion by plaintiff of such a claim "is a circuitous way of obtaining something in the nature of equity or value for its ownership [of respondent's stock], rejected in the reorganization plan" (R. 272).

The fallacy of this reasoning lies in the confusion of what plaintiff is entitled to get by virtue of its stock ownership in respondent; and what it is entitled to get by virtue of respondent's use of plaintiff's tax credit.

It is perfectly true that respondent's reorganization plan precluded plaintiff from any share in respondent's assets or earnings based upon plaintiff's ownership of stock in respondent. That stock was wiped out; and plaintiff was left, at this point, without right or interest in respondent's assets and earnings.

But after this was done—indeed because it was done—plaintiff had a tax credit. The tax credit belonged to plaintiff, not to respondent or its creditors. Respondent's reorganization plan did not and could not provide that plaintiff's tax credit must be made available to respondent or its creditors or its bankruptcy trustees.*

Plaintiff did make its tax credit available to respondent; respondent caused it to do so. This was a new transaction not contemplated by the reorganization plan. Plaintiff's claim stems from this new transaction; by no stretch of argument may it be viewed as based on its previous stock ownership in respondent.

It follows that plaintiff's present claim, based upon the use of its tax credit by respondent, does not contravene

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* Apart from other obstacles, the plan could not so provide because it was formulated in 1939 whereas the amendment of I. R. C., § 23(g)(4), was not enacted until 1942.

the provisions of the reorganization plan eliminating plaintiff's stock interest in respondent.

The Court below repeatedly emphasized that respondent's creditors did not receive full payment in the reorganization (R. 2234-5, 2368-9). Suppose so.* But plaintiff was not a guarantor of respondent's debts. It was, of course, required to subordinate its claims as a stockholder to the claims of the creditors; and that was done. But no bankruptcy law—indeed, no law whatever—required plaintiff to surrender its own asset, i.e., its tax credit, for the payment of respondent's creditors.

The Court below further held that plaintiff could not have bargained for a share of respondent's tax savings because the bankruptcy court would not have permitted it to do so (R. 2370, 2372). The argument begs the question. If plaintiff had been obligated to file consolidated returns without sharing in the tax savings, the bankruptcy court would indeed properly have vetoed any bargain. But if, as we contend, plaintiff was under no such duty and was, in Mr. Justice Jackson's words, "entitled to what fair arm's length bargaining probably would have yielded", then it is idle to speculate that the bankruptcy court might improperly have objected to a fair bargain.

We submit that, contrary to the Courts below, respondent's reorganization plan and the final order of the bankruptcy court do not preclude plaintiff's claim.

2. The Court below further held that plaintiff's claim is barred because it was not presented to the bankruptcy court (R. 2372). But why should it have been so presented? The consolidated tax returns for the year 1944 and the refund claim for the year 1942 were filed in 1945, long after respondent had emerged from reorganization in December, 1944. So far as plaintiff's claim rests on these post-

* The District Court made no such finding, and the question is in serious dispute.

reorganization events, it was obviously beyond the province of the bankruptcy court.

The consolidated tax returns for the year 1943 present a somewhat different picture. They were filed in July 1944; at that time respondent was still in the hands of its reorganization trustees. So far as plaintiff's claim rests upon the filing of these tax returns, it was therefore originally directed against the trustees. But at the end of the reorganization in December, 1944, respondent assumed all obligations of the trustees (R. 1711-3); and that included their liability for the claim at bar.

Even during the reorganization, plaintiff would have had the statutory privilege of asserting its claim (then directed against the trustees) in any court of competent jurisdiction, wholly outside the bankruptcy proceedings; § 66 of the (old) Judicial Code, 28 U. S. C. § 125 (old). That statute (now 28 U. S. C. § 959) was applicable to railroad reorganizations under § 77 of the Bankruptcy Act; *Thompson* v. *Texas Mexican R. Co.*, 328 U. S. 134, 138 (1946). It "abrogated the rule that a receiver [or trustee] could not be sued without leave of the court appointing him, and gave the citizen the unconditional right to bring his action in the local courts"; *Gableman* v. *Peoria, D. & E. R. Co.*, 179 U. S. 335, 338 (1900); *Texas & P. R. Co.* v. *Johnson*, 151 U. S. 81, 101 (1894). It follows *a fortiori* that now—after the end of the reorganization, the discharge of the trustees and the assumption of their liabilities by respondent—plaintiff is likewise free to assert its claim in any appropriate forum of its choice, without any requirement to present it to the bankruptcy court. *Chicago G. W. R. Co.* v. *Hulbert*, 205 Fed. 248, 250-1 (C. C. A. 8, 1913); *American Brake S. & F. Co.* v. *Pere Marquette R. Co.*, 263 Fed. 237, 240 (D. C., E. D. Mich., 1920); *Lassiter* v. *Norfolk S. R. Co.*, 163 N. C. 19, 21-22, 79 S. E. 264 (1913).

CONCLUSION

This "serious and important litigation" has traveled a most unusual road. The District Court, after a thirteen-day trial and upon a voluminous record (R. 264), reached its conclusion on a ground not urged or briefed by any of the parties. The majority below affirmed; but it rejected the major ground advanced by the District Court; instead, it substituted its own grounds; to do so it sought in effect to constitute itself as the trial court. The majority opinions below are the result: Shot through with improper and erroneous findings of fact, misconstruction of the federal tax and bankruptcy laws, improper and erroneous application of the rules of fiduciary law, lack of regard for local law—all intertwined and inseparable grounds for the decision below. One judge below dissented; and three judges below (Denman, Pope and Fee) thought that the case should be reheard en banc.

When the case came to this Court, the only Justice who reached the merits likewise voted to reverse. The result thus is that, of the four appellate judges passing on the merits, two voted for affirmance and two for reversal.

Thus, the cleavage among the several judges who have so far heard this case has been deep, vehement and fundamental. They have voiced several conflicting points of view, each of broad significance not only for this litigation, but for countless future controversies.

Undoubtedly, these conflicts and errors reflect the difficulty of the issues involved and the large amount at stake. Landmark cases, such as the instant one, beget such deep-seated differences. They likewise require and justify hearing by this Court to set those conflicts at rest authoritatively and finally.

For all the reasons stated herein, we respectfully urge that substantial justice for the petitioners and for the thousands of stockholders of plaintiff justifies the granting of this petition for certiorari.

Dated: November 9, 1953.

Respectfully submitted,

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